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William F. Caton
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: Viacom International Inc.
Response to September 19, 1994 Request
for Information (JK-1200C)
MM Docket 92-266 (Cable Rate Regulation)

Dear Mr. Caton:

On behalf of Viacom International, Inc. enclosed for filing is a copy of the original Response to the above-referenced Request for Information. A facsimile copy of this document was filed with the Commission yesterday, September 27, 1994. Please associate this filing with that document.

Respectfully submitted,


Michael K. Baker

MKB:blw
Enclosure

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MTV NETWORKS
**AFFILIATE
SALES AND
MARKETING**

ORIGINAL

Mark Rosenthal
Executive Vice President

September 27, 1994

SEP 28 1994

Meredith J. Jones, Chief
Cable Services Bureau
Federal Communications Commission
2033 M Street, N.W.
Washington, D.C. 20554

Re: Response to September 19, 1994 Request
for Information (JK-1200C)
MM Docket No. 92-266 (Cable Rate Regulation)

Dear Ms. Jones:

We are in receipt of your letter of September 19, 1994 to Frank Biondi, President and Chief Executive Officer of Viacom International Inc. ("Viacom"). Mr. Biondi has referred this matter to me for response on his behalf. Viacom welcomes this opportunity to further assist the Federal Communications Commission in understanding the nature of the cable programming marketplace and the critical impact that its "going-forward" rules will have on the programming industry and the American viewing public it serves. Based on our conversations with Deputy Bureau Chief Kathy Wallman, we are responding to your Request for Information on behalf of Viacom's MTV Networks division, which owns the advertiser-supported program services MTV: Music Television, VH-1/Video Hits One, and Nickelodeon (comprised of the Nickelodeon and Nick at Nite programming blocks). We are also providing certain pertinent information with respect to MTV Latino (which is owned by Viacom's wholly-owned subsidiary MTV Latino Inc.) and Comedy Central (which is owned by a general partnership in which a subsidiary of Viacom is a general partner). The negotiation of Comedy Central's affiliation agreements is the responsibility of MTV Networks Affiliate Sales and Marketing. In addition, we are providing relevant information with respect to Showtime Networks Inc., a subsidiary of Viacom.

As we have stated in our previous filings with the Commission in this docket, and as more fully discussed at pages 6 and 7 below, we strongly urge the Commission to adopt substantially enhanced incentives for cable operator investment in satellite-delivered program services while ensuring that the incentives are neutral with respect to both the "new" or "already carried" status of a service as well as the cost of a service. We also repeat our concern that FCC measures designed to allow operators flexibility in offering services on an a la carte basis be carefully crafted to avoid undercutting the long-established economic model for the development and provision of affordable, quality cable programming.

Q.1: What specific forms of monetary or non-monetary consideration, other than license fees, are involved in agreements for carriage of your programming services on cable systems?

- a. Do these forms of consideration generally vary depending on whether the programming services are newly offered services, new to a system, or continuing on a system?*
- b. Do these forms of consideration generally vary depending on the size of the operator?*
- c. What specific obligations (e.g., promotional obligations) do you generally make as a programmer in carriage agreements?*
- d. What specific obligations do cable operators generally agree to undertake in carriage agreements?*
- e. What is the typical dollar amount value of each of the above forms of consideration?*

A.1: Other than license fees, the specific forms of monetary or non-monetary consideration which a cable operator might provide in an agreement for carriage of MTV Networks' program services on its cable systems generally include the following. Viacom believes these forms of consideration are common to the carriage agreements of a number of programmers:

- the commitment of an operator to carry the services to a minimum number of subscribers (measured on an overall basis, rather than system-by-system);
- the commitment of an operator to carry the services to a minimum percentage of its total number of subscribers (generally measured on an overall and system-by-system basis);
- the commitment of an operator not to delete MTV Networks' services from systems during the term of the agreement;
- an operator's agreement to provide MTV and VH-1 in stereo; and
- a specific prohibition against carrying MTV Networks' services on an a la carte basis or on a tier with premium services.

In addition to the consideration which is provided by an operator for carriage of a service, like other programmers, we may make certain incentive payments in the ordinary course of business in support of the launch or carriage of our services. This is particularly true for our newer services, such as Comedy Central and MTV Latino. For our more established services, such as MTV and Nickelodeon, we may provide operators with marketing support (i) to promote MTV Networks' services in a particular market, (ii) to insert promotional advertisements for the services in systems' local ad availabilities (we provide all of our

advertiser-supported services in a manner which allows operators to sell and insert local advertising and sponsorships), or (iii) as an incentive for carriage of the services on a specific channel on their systems.

The forms of consideration described above may vary according to the size (and marketing significance) of the specific markets in which an operator is carrying the applicable service or services, and may also vary depending on the number of subscribers served by a system or operator.

While MTV Networks does not generally undertake specific promotional obligations in its standard affiliation agreements, as a matter of ordinary business dealings MTV Networks aggressively markets and promotes its services to both distributors and consumers. In fact, a very substantial portion of the operating budget of each of MTV Networks' services is devoted to these activities, which may include national and local sweepstakes and promotions, concert tour sponsorships, and other marketing events. Alternatively, and with respect to larger MSOs, MTV Networks sometimes does contractually undertake to conduct such activities by committing to spend agreed-upon amounts of money in these MSOs' markets, but there is no "typical dollar amount value" of any of these forms of consideration.

- Q.2: How frequently do carriage agreements for your programming service require operators to carry programming on a regulated tier, provide for carriage exclusively on an a la carte basis, or give operators the option to carry your programming services on an a la carte basis?*
- a. Does this generally vary depending on whether the programming services are newly offered services, new to a system, or continuing on a system?*
 - b. Does this generally vary depending on the size of the operator?*
 - c. What other specific factors have been relevant to such agreements?*

A.2: MTV Networks' standard affiliation agreement requires cable operators to carry MTV Networks' program services on a 24-hour per day, 365-day per year basis on either the "basic tier" (defined in MTV Networks' standard agreement as the level of cable television service received by all subscribers to a system) or the "expanded basic tier" (defined as the level of service which is received by the second most numerous group of subscribers to a system, provided that such level must be received by at least eighty percent (80%) of the system's subscribers). Because of the manner in which particular systems are configured, however, certain affiliates have negotiated for the right to launch and continue to carry MTV Networks' services on a tier containing a specified minimum number of services, which may have a slightly lesser penetration.

MTV Networks does not permit its cable affiliates to carry any MTV Networks service on a stand-alone or a la carte basis, as a premium service, or with any such service for a single or combined charge. As relatively new services, Comedy Central and MTV Latino, on the other hand, do permit their cable affiliates to carry those services on an a la carte basis under specified conditions, including the payment of an increased license fee to partially compensate these networks for the actual and anticipated loss of national advertising sales revenues which results from carriage on such a basis. MTV Networks' carriage policy does not vary depending on whether the program services are newly offered on a system or on the size of the operator or the system.

The basis for MTV Networks' policy against a la carte carriage of its services is that it is the "magna carta" of an advertiser-supported network's business that it be available to the broadest number of people. Although these networks are not necessarily watched by all receiving households, such broad distribution means that all cable subscribers can watch these services whenever they want, thereby increasing consumer awareness of the services and ultimately helping to increase our viewership. This is of paramount importance to Viacom. Indeed, in one instance, Viacom, through its MTV Networks division, commenced an action in Federal District Court for the Southern District of New York against an affiliate who was carrying MTV, Nickelodeon and VH-1 on an a la carte basis in violation of the affiliate's contracts. Ultimately, the matter was settled by the parties and the affiliate resumed carriage of the services on a regulated tier. In addition, since advertiser-supported networks have traditionally been available on the basic level of service -- where, for a single fee, subscribers receive a broad range of services -- as a programmer Viacom believes as a matter of public policy that it is not in the best interest of consumers to permit an operator to move such services to an a la carte level or offer them in some other manner in which these networks are available to subscribers only for a (potentially substantial) additional fee. Nor is it in the consumers' interest to limit programmer revenues and thus reduce the resources available for investment in programming. Further, if cable operators are encouraged to retier already-carried networks, potentially the entire basis for the economic relationship between the operator and the network will be severely impaired, since retiering would reduce the number of subscribers and thereby adversely affect the network's advertising and other revenue. Yet, the network must continue to meet its programming and other contractual commitments entered into on the reasonable expectation that carriage on the basic level of service would continue.

Q.3: Do carriage agreements for your programming services involve alteration of the terms of carriage for other programming services? If yes, please provide specific examples.

a. Do such terms generally vary depending on whether the programming services are newly offered services, new to a system, or continuing on a system?

- b. Do such terms generally vary depending on the size of the operator?*
- c. What other specific factors have been relevant to such agreements?*

A.3: MTV Networks' affiliation agreements do not call for alteration of the terms of carriage agreements for other program services.

***Q.4:** Do carriage agreements for your programming involve any requirements or provisions for "bundling" of programming services, including programming you provide or other programming services?*

A.4: As stated in the response to Question 2, MTV Networks' affiliation agreements require that the services be carried on tiers with other program services, although there is no contractual requirement that the individual MTV Networks services be carried with one another or with Comedy Central. Fundamental to our carriage agreements, however, is MTV Networks' prohibition against a la carte carriage.

***Q.5:** When contracting with a large MSO, do the terms for carriage generally apply to all systems owned by the MSO, or do the terms vary by particular system? If the terms vary, what specific factors are relevant to different carriage terms, either to the programmer or the operator?*

A.5: When contracting with a large MSO, the terms for carriage generally apply to all systems owned by the MSO, although they may vary slightly if the MSO has systems which are located in the significant Designated Market Areas of New York (because of its dominance in the advertising community) or Los Angeles (because of the number of residents in the music, television and other entertainment industries). In such instances, MTV Networks may commit to marketing efforts and other forms of support in exchange for placement of its services on a specific channel number, or for local marketing, advertising and/or other promotional activities.

***Q.6:** In what ways, if any, has the onset of rate regulation altered the terms of carriage for your programming services with cable operators or changed the requested terms of carriage?*

A.6: The onset of rate regulation has significantly changed the terms of carriage requested by MSOs for the MTV Networks services. First, it has become a rare negotiation of an affiliation agreement when an operator does not strenuously bargain for the right to carry our services on an a la carte basis. (As noted above, MTV Networks does not permit a la carte carriage.) Similarly, it is becoming increasingly common for operators to expect the right to

delete carriage of our services during the term of their agreements (without regard to the loss of national advertising sales revenues that would be associated with such deletion). Such discussions often include intimations by the operators that they will drop our services upon the expiration of their existing affiliation contracts if we do not accede to their requests.

By artificially constraining operators' ability and incentive to appropriately adjust their retail rates, rate regulation has also hampered MTV Networks' ability to recover rising programming costs through increased license fees. This is in part because the current permitted programming cost mark-up is insufficient, as more fully explained in our answers to your Questions 7 and 8 below. Additionally, many operators cite rate regulation as the reason they cannot commit to launch new services, or to carry on a full-time basis services which their systems may currently carry on a part-time basis (such as VH-1 and Comedy Central) because of operator uncertainty with respect to permitted packaging and marketing of new services. Further, rate regulation has diminished operator incentive and ability to increase channel capacity for the purpose of adding services.

Prior to rate regulation, Comedy Central did not authorize carriage on an a la carte basis. However, as a relatively new service, Comedy Central has had no choice but to change its policy in order to increase its chances of being carried, and MTV Latino (which was launched on October 1, 1993) has been offered as an a la carte service since its launch because operators refused to carry it on a regulated tier.

Q.7: Based on your experience, what specific incentives do you believe are necessary to encourage cable operators to carry additional and newly created programming services? How can the Commission create such incentives through its rate regulations?

Q.8: How should the Commission fashion regulations that will not create inappropriate incentives for operators to add or delete low-cost, or more expensive, programming services? Are specific incentives necessary to encourage operators to carry low-cost or no-cost programming services? How can the Commission create such incentives through its rate regulations?

A.7, A.8: As stated in our June 29, 1994 Comments (a copy of which is enclosed for your convenience), Viacom believes that the regulations as they currently exist will impede and discourage the carriage of additional programming, whether it be already existing program services which are seeking distribution on systems where they are not already carried or newly created services seeking to break into the marketplace. It is critical, however, that the regulations do not favor one class of programming over another class -- whether lower vs. higher fee services or new vs. established services. For this reason, an enhanced flat fee mark-

up on no- and low-cost programming, while a reasonable approach to restoring marketplace incentives for carriage of that type of programming, should not be adopted in isolation. Without parallel measures to enhance the mark-up on already-carried programming, operators' investment dollars will be artificially skewed toward the addition of services and away from supporting the promotion of and increased investment in the programming of existing services.

Because the debate on the going-forward rules has focused primarily on incentives for adding channels, Viacom has concentrated in its previous Comments on corresponding ways to reward operator support for already-carried program services. (Of course, any incentives for the addition of regulated channels should apply as well to a program service carried on a half-time or lesser basis, sharing a channel with another service, if and when such program service is carried on a channel on a full-time basis, thereby increasing the number of channels on the regulated tier.) **Specifically with respect to services already carried on a system, Viacom has proposed an "average percentage margin" plan, which would allow operators an enhanced mark-up on incremental increases in license fees of already-carried services that is equal to the average percentage margin embedded in a system's benchmark rates.**¹ Prompt FCC adoption of Viacom's proposal -- or some other significant improvement on the meager 7.5% mark-up on license fee increases -- will ensure that incentives to invest in both new and existing program services are enhanced in an evenhanded fashion. Moreover, to ensure that FCC regulations promote continued investment in already-carried services, the FCC's rules must permit operators to pass through increased programming costs in a prompt manner and without the necessity of a local franchising authority's approval.²

Q.9: What specific incentives are necessary to encourage programming vendors to develop new programming services? How can the Commission create such incentives through its rate regulations?

A.9: The Commission's rate regulations should avoid undermining the longstanding economic models that have served as the engine for the cable industry's tremendous contribution to the expansion of video programming alternatives. As a threshold matter, the continued development and launch of premium program services requires that these types of services remain beyond the scope of regulation, whether offered on an a la carte basis or in discounted packages. As for advertiser-supported programming, the continued growth of reasonably priced program services requires that operators not be discouraged from carrying

¹ See Comments of Viacom in MM Docket No. 92-266 (filed June 29, 1994) at 8-10.

² See id. at 11-17.

such services on the broad, widely distributed tiers which are critical to the provision of quality programming at reasonable license fees.

The viability of advertiser-supported (the so-called "basic") program services turns, after all, on a programmer's ability to distribute the service to the maximum number of subscribers. If programmers launching a new service (or attempting to expand the carriage of an existing service) are forced to accept carriage on an a la carte basis, then subscribers' retail rates will rise as the service attempts to recover both the additional marketing costs entailed in a successful a la carte offering and the lost revenues resulting from the still inevitable loss of advertising reach. The end result will be either higher rates to subscribers or reduced quality programming -- or both.

Viacom is concerned that any proposal that would encourage direct migration or "cloning"³ of advertiser-supported services will significantly undermine the foundation for affordable, advertiser-supported programming. FCC rules that would drive such program services into an a la carte world might allow certain program formats to thrive (e.g., infomercial or shopping-based services), but the viability of many popular formats -- including both broadly targeted services and those aimed at various niche audiences -- would be seriously impaired.

***Q.10:** How should the Commission's going forward regulations govern the migration of programming services from regulated tiers to unregulated individual or package offerings?*

A.10: While Viacom recognizes that the interests of the viewing public can be served by increased choice, neither subscriber interests nor the welfare of the programming industry (as explained above) would be served by FCC regulations that artificially encourage the migration of regulated program services to a la carte carriage. Therefore, the Commission should clarify that, whatever a la carte guidelines are adopted, operators' ability to migrate program services remains subject to existing contractual agreements with programmers. Further, if a programming agreement is silent on the issue of tier location, then the programmer's

³ Even if "cloned" from a regulated tier to an unregulated cluster tier, services on regulated tiers would lose distribution as subscribers drop such tiers for various unregulated packages (some of which would exclude a given "cloned" service). The ultimate impact on consumers, contrary to the presumed intent, would include higher retail rates for subscribers to the regulated tiers, as all services on those tiers (whether "cloned" or not) would need to raise license fees -- or else reduce programming expenditures and quality -- to offset lost advertising revenues caused by the drop in audience reach due to subscriber migration to the cloned tier, away from the regulated "cable programming service" tier.

affirmative consent should be required before its service can be removed from a regulated tier. Indeed, in Viacom's view, the Commission is not statutorily empowered to preempt contractual obligations in programming contracts with rules that would permit a la carte carriage where the affiliation agreement provides otherwise, expressly or by implication.

At the same time, FCC promulgation of certain "reverse migration" guidelines -- which would allow an operator (subject to any contrary contractual limitations in an affiliation agreement) to move a service launched on an a la carte basis to a regulated tier without running afoul of FCC regulations -- will ameliorate the impact on programmers of any guidelines allowing operators greater flexibility to migrate program services to a la carte carriage in the first instance.

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Through its Showtime Networks Inc. ("SNI") subsidiary, Viacom also owns the premium services Showtime and The Movie Channel, as well as FLIX, a low-priced, "added-value" premium service. SNI is planning to launch additional added-value premium services in 1995. While we have answered your questions with information about our advertiser-supported services, we thought that some information about Viacom's premium services might also be helpful.

First, regarding packaging of Viacom's premium services, SNI's carriage agreements require that its premium services be offered on an a la carte basis, and also permit, and in fact provide incentives for, those services to be packaged with other services.

Second, in response to your questions regarding consideration other than license fees in carriage agreements, SNI seeks contractual commitments from its distributors to favorably package, promote and otherwise market its services. To attract new subscribers, SNI spends significant sums on direct marketing and on other advertising and promotion of its services. In some cases, SNI markets on its own with the cooperation of a distributor (e.g., the distributor provides names and addresses of potential subscribers); in other cases, SNI supports a distributor's efforts. SNI typically supports the launch of one of its services in a system, whether it is a launch of an established service or a new service. SNI also conducts training sessions for its distributors' customer service personnel. SNI also provides financial incentives for performance-related factors, such as offering its services in discounted packages, increased penetration of a service (the percentage of basic subscribers that also subscribe to the premium service), percentage or unit growth and monthly payment guarantees.

Finally, in response to your Questions 7 and 9, the simplest incentive for cable operators to launch new premium services, such as SNI's new "added-value" services, would be a clear statement by the Commission that premium services remain outside the scope of rate

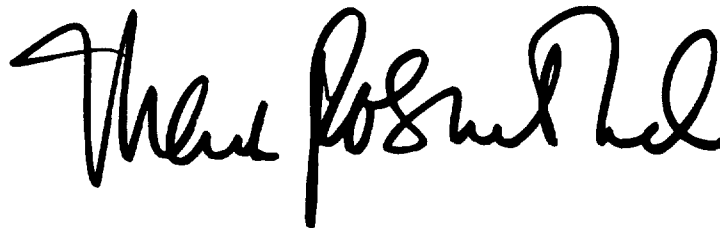
Meredith J. Jones
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regulation, whether or not they are packaged, so long as such services are also available on an a la carte basis.

Viacom hopes that the information provided above will facilitate the adoption of going-forward rules that restore operator investment in program services universally, without artificial distinctions based on the status (i.e., existing vs. new) or the cost (i.e., no- or low-fee vs. higher fee) of a program service. Viacom also hopes that its responses to Commission inquiries have made plain the danger of adopting the "migration" or "cloning" packaging proposals that would impede or destroy successful marketplace models for satellite-delivered programming.

Should you need any further information, please do not hesitate to contact us.

Sincerely,

A handwritten signature in black ink, appearing to read "Meredith Jones". The signature is fluid and cursive, with the first name "Meredith" written in a larger, more prominent script than the last name "Jones".